NV Alliance Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri

COURT OF APPEAL (PUTRAJAYA) — CIVIL APPEAL NO W-01–149 OF 2010
RAUS SHARIF PCA, MOHD HISHAMUDIN AND ANATHAM KASINATHER JJCA
4 NOVEMBER 2011

Revenue Law — Income tax — Deduction — Cash incentives — Appellant paying its marketing agents cash incentives as motivation to increase sales — Whether appellant entitled to deductions pursuant to s 33(1) of the Income Tax Act 1967 in relation to the cash incentives — Whether cash incentive expenses were 'entertainment' expenses — Whether cash incentives came within ambit of item (i) of s 39(1) of the Income Tax Act 1967

Statutory Interpretation — Canons of construction — Ejusdem generis principle — When particular words follow general words — Determining whether cash incentive expenses come within meaning of 'or hospitality of any kind' in Income Tax Act 1967

Statutory Interpretation — Canons of construction — Noscitur a sociis — Determining whether cash incentive expenses come within the meaning of 'or hospitality of any kind' in Income Tax Act 1967 — Whether words preceding the word in question must be taken into account

The appellant was in the business of marketing of burial plots, urn compartments and funeral packages. In the course of its business the appellant appointed agents to undertake the marketing functions. The agents were paid commissions for their work. With the aim of motivating agents to increase sales, the appellant introduced incentive schemes whereunder, the agents on achieving certain set sales targets were paid various types of incentives including cash incentive. The appellant in its tax returns claimed deductions pursuant to s 33(1) of the Income Tax Act 1967 ('the Act') in relation to the cash incentives paid out to its employees. The respondent refused to allow the deductions on the ground that such cash incentive expenses were 'entertainment' expenses and as such were not allowed by item (i) of s 39(1) of the Act as it stood then (ie before the coming into force of the amendment to the provision via the Finance Act 2003 (Act 631)). The respondent took the position that the cash incentives were expenses for 'hospitality' and were therefore entertainment expenses. The Special Commissioners of Income Tax ('SCIT') allowed the appellant's appeal against the respondent's decision. The

High Court however allowed the respondent's appeal against the decision of the SCIT. Hence this appeal by the appellant against the decision of the High Court. The issue to be decided was whether the payment of the cash incentives were entertainment expenses and as such came within the ambit of item (i) of s 39(1) of the Act.

Held, allowing the appeal with costs:

(1) The cash incentive payments were not 'hospitality' expenses, and, hence, were not entertainment expenses. The cash incentive payments did not come under item (i) of s 39(1) of the Act. It followed then that the appellant was entitled to the deductions claimed in respect of the cash incentive payments (see para 15).

(2) This was a case where the *noscitur a sociis* rule of statutory interpretation was applicable. According to this rule of interpretation, where two or more words which are susceptible of analogous meaning are coupled together in a statutory provision, they are understood to be used in their cognate sense. They take as it were, their colour from each other, the meaning of the more general being restricted to a sense analogous to that of the less general. It followed then that the meaning of the more general words 'or hospitality of any kind' must be restricted to a sense analogous to that of the less general words, namely, 'food, drink, recreation'. In determining as to whether or not the cash incentive expenses come within the meaning of 'or hospitality of any kind', the court has to take into account the words preceding that word, that is to say, the words 'food, drink, recreation'. If the meaning to be given to the words 'or hospitality of any kind' is limited accordingly, then, the cash incentives expenses clearly cannot come within the meaning of these words ('or hospitality of any kind') (see para 15).

(3) Alternatively, the same finding would be arrived at if the court were to apply the related *ejusdem generis* rule. According to this related rule of statutory interpretation, the meaning to be given to the general words 'or hospitality of any kind' must be restricted to the same genus as 'food, drink, recreation'. In other words, the words 'or hospitality of any kind' must be given a meaning that is *ejusdem generis* with 'food, drink, recreation'. If the meaning to the expression, 'or hospitality of any kind' is so confined, clearly, it would exclude the payments of cash incentive (see para 16).

[Bahasa Malaysia summary

Perayu dalam perniagaan pemasaran plot-plot pengebumian, petak-petak kendi dan pakej-pakej pengebumian. Semasa perniagaannya perayu telah melantik ejen-ejen untuk menuruskan fungsi-fungsi pemasaran. Ejen-ejen telah dibayar komisyen untuk kerja mereka. Dengan tujuan memberi

perangsang kepada ejen-ejen untuk meningkatkan jualan, perayu telah memperkenalkan skim insentif di mana, ejen-ejen yang mencapai sasaran jualan tertentu yang ditetapkan telah dibayar pelbagai jenis insentif termasuk insentif berbentuk wang tunai. Perayu dalam penyata cukainya menuntut potongan menurut s 33(1) Akta Cukai Pendapatan 1967 ('Akta tersebut') berkaitan insentif berbentuk wang tunai yang telah dibayar kepada pekerja-pekerja. Responden enggan membenarkan potongan atas alasan bahawa perbelanjaan insentif berbentuk wang tunai merupakan perbelanjaan 'entertainment' dan oleh itu tidak dibenarkan oleh item (i) kepada s 39(1) Akta tersebut pada masa itu (iaitu sebelum pindaan kepada peruntukan berkuat kuasa melalui Akta Kewangan 2003 (Akta 631)). Responden berpendapat bahawa insentif berbentuk wang tunai merupakan perbelanjaan untuk 'hospitality' dan oleh itu merupakan perbelanjaan hiburan. Suruhanjaya Khas Cukai Pendapatan ('SKCP') telah membenarkan rayuan perayu terhadap keputusan responden. Walau bagaimanapun Mahkamah Tinggi telah membenrakan rayuan responden terhadap keputusan SKCP. Justeru itu rayuan ini oleh perayu terhadap keputusan Mahkamah Tinggi. Isu yang perlu diputuskan adalah sama ada bayaran untuk insentif berbentuk wang tunai itu merupakan perbelanjaan hiburan dan oleh itu terjatuh dalam skop item (i) kepada s 39(1) Akta tersebut.

Diputuskan, membenarkan rayuan dengan kos:

(1) Bayaran insentif berbentuk wang tunai itu bukan perbelanjaan 'hospitality', dan, justeru itu, bukan perbelanjaan hiburan. Bayaran insentif berbentuk wang tunai tersebut tidak terjatuh di bawah item (i) kepada s 39(1) Akta tersebut. Adalah diikuti bahawa perayu berhak mendapat potongan yang dituntut berkaitan bayaran insentif berbentuk wang tunai tersebut (lihat perenggan 15).

(2) Ini merupakan kes di mana rukun *noscitur a sociis* berhubung tafsiran statutori adalah terpakai. Menurut rukun tafsiran ini, di mana dua atau lebih perkataan yang mempunyai maksud analogi bersama dalam peruntukan statutori, ia difahami agar digunakan dalam bentuk asalnya. Perkataan-perkataan tersebut saling digunakan, dengan maksud lebih umum terhad kepada sifat analogi berbanding kepada yang kurang umum. Adalah diikuti bahawa maksud lebih umum perkataan-perkataan 'or hospitality of any kind' hendaklah terhad kepada sifat asal dan bukan bersifat umum, seperti, 'food, drink, recreation'. Bagi menentukan berhubung sama ada atau tidak perbelanjaan insentif bernetuk wang tunai terangkum dalam maksud 'or hospitality of any kind', mahkamah hendaklah mengambil kira perkataan-perkataan sebelum perkataan tersebut, iaitu, perkataan-perkataan 'food, drink, recreation'. Jika maksud yang diberikan untuk perkataan-perkataan 'or hospitality of any kind' sejajarnya terhad, maka, perbelanjaan insentif berbentuk wang

tunai tersebut jelas tidak terangkum di bawah maksud perkataan-perkataan tersebut ('or hospitality of any kind') (lihat perenggan 15).

(3) Secara alternatif, penemuan adalah sama jika mahkamah menggunakan rukun *ejusdem generis* berkaitan. Menurut rukun tafsiran statutori berkaitan ini, maksud untuk diberikan kepada perkataan-perkataan umum 'or hospitality of any kind' hendaklah terhad kepada genus yang sama seperti 'food, drink, recreation'. Dalam erti kata lain, perkataan-perkataan 'or hospitality of any kind' hendaklah diberikan maksud yang *ejusdem generis* dengan 'food, drink, recreation'. Jika maksud ungkapan, 'or hospitality of any kind' adalah terhad, maka dengan jelas, ia mengecualikan bayaran insentif berbentuk wang tunai tersebut (lihat perenggan 16).]

Notes

For cases on deduction, see 10 *Mallal's Digest* (4th Ed, 2011 Reissue) paras 2500–2543.

For cases on *ejusdem generis* principle, see 11 *Mallal's Digest* (4th Ed, 2011 Reissue) paras 1719–1748.

For cases on *noscitur a sociis*, see 11 *Mallal's Digest* (4th Ed, 2011 Reissue) paras 1743–1747.

Legislation referred to

Finance Act 2003
Income Tax Act 1967 ss 18, 33(1), 39(1)(i), (l), 99

Appeal from: Civil Suit No R1–14–04 of 2009 (High Court, Kuala Lumpur)

WSW Davidson (Francis Tan Leh Kiah and Cheh Keng Soon with him) (Azman Davidson & Co) for the appellant.

Neng Juliana Ismail (Senior Revenue Counsel, Office of the Inland Revenue Board Malaysia) for the respondent.

Mohd Hishamudin JCA (delivering judgment of the court):

[1] This is an appeal by the appellant company (NV Alliance Sdn Bhd) against the decision of the High Court of Kuala Lumpur (Appellate and Special Powers Division) of 22 February 2010. At the High Court the learned High Court judge had allowed the respondent's (the Director General of Inland Revenue) appeal against the decision of the Special Commissioners of Income Tax ('the Special Commissioners') who had, on appeal by appellant to them pursuant to s 99 of the Income Tax Act 1967 ('the Act'), against the tax assessment of the appellant by the respondent, allowed the appellant's appeal.

[2] We, unanimously, are allowing the appeal with costs. Our grounds are as follows.

[3] We begin by setting out briefly the facts.

[4] The appellant is in the business of marketing of burial plots, urn compartments and funeral packages. In the course of its business the appellant needs the services of marketing personnel; and so it appoints agents to undertake the marketing functions. The agents are paid commissions for their work. But with the aim of motivating agents to increase sales, the appellant introduced incentive schemes. Under the incentive schemes, the agents on achieving certain set sales targets are paid various types of incentives. One type of incentive is cash incentive.

[5] The appellant in its tax returns had claimed deductions from its gross income expenses that it paid out to its employees as cash incentives under the incentive schemes. This claim for deductions is made pursuant to sub-s (1) of s 33 of the Act. This subsection provides:

> 33 Adjusted income generally
>
> (1) Subject to this Act, the adjusted income of a person from a source for the basis period for a year of assessment shall be an amount ascertained by deducting from the gross income of that person from that source for that period all outgoings and expenses wholly and exclusively incurred during that period by that person in the production of gross income from that source.

[6] It is common ground in this appeal and it is also the finding of the Special Commissioners that the cash incentive payments — the subject matter of this appeal — prima facie, do qualify for deductions by virtue of the above provision, being expenses wholly and exclusively incurred by the appellant in the production of its gross income from a source.

[7] However, notwithstanding this, the Director General of Inland Revenue ('the Director General') still refuses to allow the deductions on the ground that such cash incentive expenses are 'entertainment' expenses; as such, the deductions are not allowed by item (i) of sub-s (1) of s 39 of the Act. Section 39(1)(l) as it stood then (ie before the coming into force of the amendment to the provision via the Finance Act 2003 (Act 631)) reads:

> Deductions not allowed.
>
> (39) (1) Subject to any express provision of this Act, in ascertaining the adjusted income of any person from any source for the basis period for a year of assessment no deduction from the gross income from that source for that period shall be allowed in respect of —
>
> (a) -(k) [not applicable]

(l) any expenses incurred in the provision of entertainment including any sums paid to an employee of that person for the purpose of defraying expenses incurred by that employee in the provision of entertainment:

[8] In s 18 of the Act, 'entertainment' is defined as:

'entertainment' includes —

(a) the provision of food, drink, recreation or hospitality of any kind; or

(b) the provision of accommodation or travel in connection with or for the purpose of facilitating entertainment of the kind mentioned in paragraph (a),

by a person or an employee of his in connection with a trade or business carried on by that person.

[9] There is no definition of the word 'hospitality' in the Act.

[10] The present appeal concerns only the payment of cash incentives; whether such payments are entertainment expenses and hence come within the ambit of item (i) of sub-s (1) of s 39 of the Act.

[11] The respondent/director general takes the position that the cash incentives, as paid by the appellant to its employees, are expenses for 'hospitality' and are, therefore, entertainment expenses; and, therefore, item (i) of sub-s (1) of s 39 of the Act applies.

[12] At the hearing before them, the Special Commissioners found the facts which are set out in the case stated at para 6 and allowed the appellant's appeal. In allowing the appeal, they gave their grounds of decision as follows:

> Now, the question before us is whether all the expenses incurred by the appellant are in a form of entertainment within the meaning of s 18 of the Act. Therefore we have to examine what is the true nature of expenses based on the evidence and documents adduced before us.
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> According to Mr Soo Wei Chian (AW1), an executive director of the appellant, all the expenses were made to the agents who achieve the next targets as set out in the respective notices to them. The incentives are in the nature of additional remuneration paid to agents who met the sales target. The AW1 further explained that the reason for introducing the incentives is to motivate agents to work harder to increase the sales of the appellant.
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> According to Mr Yap Hoi Chong (AW2) who work as an agent of the appellant, his income is in a form of commission based on his performance. Besides commission, he was also paid some incentives such as sales target incentives, agency sales competition incentives, quarterly incentives and cash incentives if he achieves certain target.

Based on the facts of the case, we are of the view that the expenses incurred are solely with the object of promoting the business. In other words the incentive is to motivate agents to work harder to increase the sales of the appellant as stated by AW1 and AW2. Therefore we are of the opinion that the expenses are [related to] the performance of profit earning operations would be of a revenue nature. We cannot agree with the respondent that the expenses are constitute as an entertainment within the meaning of s 18 of the Act; and therefore not allowable as deduction in the ascertaining of adjusted income pursuant to s 39(1)(l) of the Act.

In view of the above facts, we are of the opinion that the expenses in this appeal were wholly and exclusively incurred in the production of the appellant's gross income pursuant to s 33(1) of the Act and not prohibited from deduction by virtue of s 39(1)(l) of the Act before its amendment by Act 631 of 2003.

[13] The Special Commissioners then made the following deciding order:

ADALAH DIPUTUSKAN bahawa perbelanjaan berikut:

Perbelanjaan	T/T/2000 (STTS)(RM)	T/172001 (RM)	T/T/2002 (RM)
Sales target incentives	238,948	87,993	127,295
Agency sales competition	180,000	103,710	-
Quarterly incentives	540,979	-	-
Cash incentives to agents	306,154	-	-

adalah dibenarkan sebagai tolakan di bawah seksyen 33(1) Akta Cukai Pendapatan 1967; dan penalty di bawah seksyen 113(2) Akta yang sama adalah tidak patut dikenakan dalam kes ini.

MAKA DENGAN INI ADALAH DIPERINTAHKAN bahawa rayuan ini dibenarkan.

DAN DIPERINTAHKAN SELANJUTNYA bahawa Notis-notis Taksiran bagi Tahun-tahun Taksiran 2000 (STTS), 2001 dan 2002 yang berkaitan dengan rayuan ini dipinda sejajar dengan keputusan di atas.

[14] The respondent/director general, dissatisfied with the decision of the Special Commissioners, appeal to the Appellate and Special Powers Division of the High Court of Kuala Lumpur. The High Court allowed the appeal and reversed the order of the Special Commissioners. The learned High Court judge, in her judgment, ruled that the cash incentives are 'entertainment' expenses and are, therefore, disallowed to be deducted by item (i) of sub-s (1) of s 39 of the Act. She said:

In order to determine whether the 'incentives' come within the meaning 'entertainment' under s 18 of the Act, I refer to part of the judgment of Romer LJ in *Bentleys, Stokes & Lawless v Beeson (Inspector of Taxes)* cited in the case of *Aspac Lubricants (Malaysia) Sdn Bhd v KPHDN* as follows:

> … that the purpose must be the sole purpose … If the activity be undertaken with the object of both promoting business and also with some other purpose... then the paragraph is not satisfied though in the mind of the actor the business motive may predominate …

> In the present case the incentives are paid through competitions or contests organised by the respondent where there are rules and regulations, there are specified closing dates, winners will be announced and determined by the respondent and top prizes and consolation prizes are given to winners. The incentives are paid as a reward for those sales agents who achieve the sales targets. Therefore apart from the commissions that the respondent is contractually bound to pay under the agency agreements, the sales agents are rewarded for achieving sales targets. It is therefore apparent that the payment of incentives, though with the predominant purpose of promoting the respondent's business, was also given or paid to reward those sales agents who achieve the sales targets set. Therefore the incentives were not paid solely for the purpose of promoting the respondent's business.

> Further the respondent does not include these incentives in the income statement of each sales agent. This indicates that the incentives were not part of the contractual commissions paid under the agency agreements. I agree with the appellant that these incentives are extra payments given to the sales agents over and above the commissions that they are paid for doing what they are contractually bound to do under the agency agreements. The agents are not required to fork out anything extra. Thus the incentive payments given by the respondent are by nature gratuitous without consideration. I find that there is the element of hospitality in the incentives given based on the case of *United Detergent Industries Sdn Bhd v Director General of Inland Revenue* cited by the appellant where the court said:

> > … the word 'hospitality' connotes the action of entertaining someone without that someone having so subscribe towards the cost incurred by the host for the purpose of entertaining that someone.

> > Section 18 of the Act defines 'entertainment' to include 'hospitality of any kind'. Having considered the facts I find that the SCIT has erred when it concluded that the incentives do not come within the meaning of 'entertainment'.

[15] With respect, on our part, we are unable to agree with the decision and reasoning of the learned High Court judge. In our judgment, the cash incentive payments are not 'hospitality' expenses, and, hence, are not entertainment expenses. In other words, the cash incentive payments do not come under item (i) of sub-s (1) of s 39 of the Act. It follows then that the appellant is entitled to the deductions claimed in respect of the cash incentive payments. We are in agreement with the submission of the learned counsel for the appellant that this is a case where the *noscitur a sociis* rule of statutory interpretation is applicable. According to this rule of interpretation, where two or more words which are susceptible of analogous meaning are coupled together in a statutory provision, they are understood to be used in their cognate sense. They take as it were, their

colour from each other, the meaning of the more general being restricted to a sense analogous to that of the less general (*Maxwell on The Interpretation of Statutes*, (12th Ed) at p 289). It follows then that in the present case the meaning of the more general words 'or hospitality of any kind' must be restricted to a sense analogous to that of the less general words, namely, 'food, drink, recreation'. In other words, in determining as to whether or not the cash incentive expenses come within the meaning of 'or hospitality of any kind', we have to take into account the words preceding that word, that is to say, the words 'food, drink, recreation'. In our view, if the meaning to be given to the words 'or hospitality of any kind' is limited accordingly, then, the cash incentives expenses clearly cannot come within the meaning of these words ('or hospitality of any kind').

[16] Alternatively, we would arrive at the same finding if we were to apply the related *ejusdem generis* rule. According to this related rule of statutory interpretation, the meaning to be given to the general words 'or hospitality of any kind must be restricted to the same genus as 'food, drink, recreation' (*Maxwell on The Interpretation of Statutes* at p 297). In other words, the words 'or hospitality of any kind' must be given a meaning that is *ejusdem generis* with 'food, drink, recreation'. If the meaning to the expression, 'or hospitality of any kind is so confined, clearly, it would exclude the payments of cash incentive.

[17] We, accordingly, set aside the order of the High Court and restore the deciding order of the Special Commissioners.

[18] Appeal allowed with costs.

Appeal allowed with costs.

Reported by Kanesh Sundrum